

**IT 03-8**

**Tax Type: Income Tax**

**Issue: Responsible Corporate Officer – Failure to File or Pay Tax**

**STATE OF ILLINOIS  
DEPARTMENT OF REVENUE  
OFFICE OF ADMINISTRATIVE HEARINGS  
CHICAGO, ILLINOIS**

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**THE DEPARTMENT OF REVENUE  
OF THE STATE OF ILLINOIS**

v.

**John Doe,  
Taxpayer**

**No. 00-IT-0000  
FEIN: 00-0000000  
SSN: 000-00-0000  
NOD No.: 0000  
Tax pds.: 2<sup>nd</sup> Qtr. 99 thru 1<sup>st</sup> Qtr. 01  
Charles E. McClellan  
Administrative Law Judge**

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**RECOMMENDATION FOR DECISION**

**Appearances:** Ronald Forman, Special Assistant Attorney General, for the Illinois Department of Revenue (the “Department”); Gust Dickett and James e. Dickett, of Romanoff & Dickett Ltd., for John Doe (the “Taxpayer”))

**Synopsis:**

This matter arose from a timely filed protest to a Notice of Deficiency issued by the Department to the Taxpayer on August 1, 2002 assessing penalties provided in § 1002(d) of the Illinois Income Tax Act and § 3-7(a) of the Uniform Penalty and Interest Act.<sup>1</sup> The penalties are assessed against the Taxpayer as a responsible party for failure to collect and pay over to the Department withholding taxes of employees of ABC Machine Works, Inc. for the 2<sup>nd</sup>, 3<sup>rd</sup>, and 4<sup>th</sup> quarters of 1999, all four quarters of 2000, and the 1<sup>st</sup> quarter of 2001 as required by IITA § 701.

A pre-trial order was entered on March 13, 2003, in which the issue was set forth as follows: “ . . .Whether the Taxpayer is liable for the taxes owed by Tomka [sic] Machine Works, Inc. as a responsible officer pursuant to 35 ILCS 5/1002(d).”

An evidentiary hearing was held on May 12, 2003. At the commencement of the hearing, but prior to calling the Taxpayer to testify, the parties submitted a stipulation of facts and documents. At the conclusion of the hearing, the parties elected not to file briefs.

**Findings of Fact:**

1. The Department issued Notice of Deficiency No. 0000 to the Taxpayer on August 1, 2002 assessing penalties under IITA § 1002(d) for the second and third quarters of 1999, all four quarters of the year 2000, and the first quarter of 2001. Dept. Ex. No. 1.
2. ABC Machine Works, Inc. (“ABC”) maintained a business checking account at ANY Bank for the tax periods at issue. Stip. ¶ 1.
3. Taxpayer and his sister Jane Doe were signatories on the checking account. Stip. ¶ 2.
4. During the period of August 1999 to April 2000, of the 1000 or so cancelled checks drawn on the ANY bank account, the Taxpayer signed ten checks. Jane Doe, his sister, signed the rest of them. Stip. ¶ 3, Department Ex. No. 2; Taxpayer Exs. No. 3 and 4.
5. On ABC’s annual reports filed with the Secretary of State for 1998, 1999, and 2000, all signed by Jane Doe as an authorized officer, Taxpayer is listed as

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<sup>1</sup> Unless otherwise noted, statutory references to the Illinois Income Tax Act, 35 ILCS 5/101, *et seq.*, will be noted as “IITA §”. References to the Uniform Penalty and Interest Act, 35 ILCS 735/3-1 through 11,

- president and director, Mary Doe is listed as secretary and director, and Jane Doe is listed as vice president, treasurer and director. Taxpayer Ex. No. 1.
6. Taxpayer was paid a salary on a weekly basis. All of his payroll checks were net of all payroll deductions including federal and state withholding taxes, and they were signed by Jane Doe. Stip. ¶ 4.
  7. Jane Doe signed the IL-941 forms for ABC for all four quarters of 1998, and the first quarter of 1999. Taxpayer Ex. No. 2.
  8. Taxpayer is a 44 year-old high school graduate with some college credits for courses primarily in mechanical engineering, but no credits for classes in tax, finance, or accounting, and he did not graduate from college. Tr. p. 13
  9. ABC was a machine shop started by Taxpayer's father in 1969. It engaged in the business of repairing steel rollers, gears, and other heavy steel items. *Id.* at 14.
  10. Taxpayer started working at ABC when he was twelve years old as a floor sweeper. Later, he took machinist training and became a machinist. He started working at ABC on a full time basis in 1979 and he continued to be employed there until the business closed in 2001. *Id.*
  11. From 1979 until 1984, Taxpayer worked for ABC as a machinist reporting to his father. *Id.* at 15.
  12. In 1984, Taxpayer's father died and he became president of ABC responsible for production and sales, functions formerly handled by his father. *Id.* at 16.
  13. After Taxpayer's father died in 1984, ownership of ABC changed. Prior to his death, Mr. Doe and his wife Jane, Taxpayer's mother, owned all of the ABC

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and will be noted as the "UPIA §".

- stock. Following his death, Taxpayer's mother owned 50%, and Taxpayer and his sister, Mary Doe, each owned 25%. *Id.* at 17.
14. At the same time in 1984, Mary became secretary and treasurer of ABC. *Id.* at 18.
  15. After 1984, ABC never had a board of directors meeting. *Id.*
  16. ABC retained an accountant from 1999 to 2001, but Taxpayer never saw any financial reports. *Id.* at 19.
  17. Jane Doe managed the corporate bank account. *Id.* at 20.
  18. Taxpayer signed very few checks during the audit period, and those he did sign were for COD deliveries, or other items that required payment ahead of time. *Id.* at 21.
  19. Jane Doe was responsible for managing the office and for the financial side of the business, including making bank deposits, recording sales and bank deposits, signing and filing tax returns, and Secretary of State corporate annual reports. *Id.* at 22, 31.
  20. Taxpayer was responsible for hiring and firing shop personnel. *Id.* at 32.
  21. Taxpayer was responsible for supervising the machine shop, making up bids on jobs, and for reviewing and approving materials invoices for payment. After approving bills for payment, he would give them to his sister for payment. *Id.* at 32-33.
  22. Taxpayer never looked at ABC's books which were kept in a safe. *Id.* at 37.
  23. Taxpayer never signed any of ABC's tax returns. *Id.* at 45.
  24. ABC lost four customers in the year 2000 and went out of business during August 2001. *Id.* at 39, 49.

## Conclusions of Law:

The issue in this case is whether the taxpayer is a responsible person who willfully failed to file and pay withholding taxes for ABC as required by IITA § 1002(d). Section 1002(d) of the Illinois Income Tax Act (“IITA”) imposes the penalty at issue and, in relevant part, it reads as follows:

Any person required to collect, truthfully account for, and pay over the tax imposed by this Act who willfully fails to collect such tax or truthfully account for and pay over such tax or willfully attempts in any manner to evade or defeat the tax or the payment thereof, shall, in addition to other penalties provided by law, be liable for the penalty imposed by Section 3-7 of the Uniform Penalty and Interest Act.  
35 ILCS 5/1002(d).

Section 3-7(a) of the Uniform Penalty and Interest Act (“UPIA”), in relevant part, provides as follows:

Any officer or employee of any taxpayer subject to the provisions of a tax Act administered by the Department who has the control, supervision or responsibility of filing returns and making payment of the amount of any trust tax imposed in accordance with that Act and who willfully fails to file the return or make the payment to the Department or willfully attempts in any other manner to evade or defeat the tax shall be personally liable for a penalty equal to the total amount of tax unpaid by the taxpayer including interest and penalties thereon. The Department shall determine a penalty due under this Section according to its best judgment and information, and that determination shall be *prima facie* correct and shall be *prima facie* evidence of a penalty due under this Section. Proof of that determination by the Department shall be made at any hearing before it or in any legal proceedings by reproduced copy or computer printout of the Department's record relating thereto in the name of the Department under the certificate of the Director of Revenue. . . .  
35 ILCS 735/3-7(a)

These sections, taken together, prescribe two tests to determine if an individual is personally liable for unpaid withholding tax. First, under both provisions, the person must be responsible for accounting for and paying the tax due. Second, the individual must willfully fail to file or pay the tax shown to be due on the payroll tax returns.

In this case, once the Department introduced into evidence the Notice of Deficiency under the Director's certificate, its *prima facie* case was made on the questions of responsibility and willfulness. *Branson v. Dept. of Revenue*, 168 Ill.2d 247, 261-262 (1995). The burden then shifted to the Taxpayer to overcome the Department's case. *Id.* To rebut the Department's *prima facie* case, Taxpayer had to come forward with sufficient evidence to disprove the Department's case. *Branson*, 168 Ill.2d at 262.

The statute does not define the concept of willful failure. However, in applying the penalty tax, the Illinois courts look to federal cases involving § 6672 of the Internal Revenue Code<sup>2</sup> which contains language similar to the Illinois statute. *Branson*, 168 Ill.2d at 254 (1995), *Dept of Revenue v. Joseph Bublick & Sons*, 68 Ill.2d 568 (1977). The key to liability under IRC § 6672 is control of finances within the employer corporation including the power to control the allocation of funds to other creditors in preference to the withholding tax obligations. *Haffa v. U.S.*, 516 F.2d 931 (7<sup>th</sup> Cir. 1975). The issue of willfulness is concerned with the state of the responsible person's state of mind. *Sawyer v. U.S.*, 831 F.2d 755 (7<sup>th</sup> Cir. 1987) "Willful failure to pay taxes has generally been defined as involving intentional, knowing and voluntary acts or, alternatively, reckless disregard for obvious or known risks." 168 Ill.2d at 255.

Being a corporate officer does not, *per se*, impose the duty to collect, account for and pay over the withheld taxes. *Monday v. U.S.*, 421 F.2d 1210, (7<sup>th</sup> Cir. 1970). However, an officer may have that duty even though he does not have the treasury function. *Id.* He has the duty if he has general control over corporate business affairs and participates in decisions concerning payment of creditors. *Id.*

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<sup>2</sup> 26 U.S.C. § 6672.

In this case, the record shows that ABC was a corporation that conducted business as a machine shop repairing heavy steel items such as gears and rollers. The Taxpayer's father started the company in 1969. The Taxpayer's mother and father owned all of the stock.

The Taxpayer, now 44 years old, started working for ABC when he was 12 years old sweeping floors. He graduated from high school and took some college courses in mechanical engineering, but he never graduated. He never took any courses in tax, finance or accounting. Later he took machinist training and became a machinist. He started working full time as a machinist for ABC in 1979 reporting to his father.

When the Taxpayer's father died in 1984, he became president of ABC and a 25% shareholder along with his sister who also owned 25% of the stock and held title to the office of vice-president and treasurer. The remaining 50% of the stock was owned by their mother who held the title of secretary. The three of them were directors of the company.

From 1984 until the company went out of business in 2001, the Taxpayer was responsible for running the machine shop, preparing job proposals for customers, ordering steel and supplies and developing sales, functions formerly the responsibility of his father. Taxpayer's sister managed the office, signed the annual reports filed with the Secretary of State's office, signed and filed all tax returns, and prepared and signed most of the checks to pay the corporate bills.

The Taxpayer testified that he never saw a financial statement or an audit report of the business's financial statements, if there ever was one, and he never looked at any

corporate tax returns. He spent his time managing the machine shop, preparing job proposals and trying to develop sales.

Taxpayer's testimony is credible, and consistent with the documentary evidence of record. Although the Taxpayer was president of ABC, there is no evidence in the record to indicate that he exercised any authority over corporate business affairs or had anything to do with paying creditors. There is no evidence that he knew that the withholding taxes were not being paid or that he should have known that they were not being paid. All of the evidence indicates that he ran the machine shop, and his sister ran the office.

The Department's reliance on *McLean v. Dept. of Revenue*, 326 Ill.App.3d 667, 761 N.E.2d 226 (1<sup>st</sup> Dist. 2001) is misplaced. In that case the corporate officer who was found to have willfully failed to pay the corporate sales tax due was aware of the corporation's financial difficulty, yet he continued to write checks to pay corporate creditors other than the Department. *Id.* at 676. There is no evidence in this case that the Taxpayer was aware of ABC's financial difficulties and he did not write any checks. Therefore, *McLean* is factually distinguishable from this case.

I find that he was not a responsible person who willfully failed to pay ABC's withholding taxes.

Therefore, I recommend that the Notice of Deficiency be cancelled.

Date: 7/23/2003

Charles E. McClellan  
Administrative Law Judge